

**BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF CALIFORNIA**

In the Matter of the Appeal of)	
)	
STAR ROOFING COMPANY, INC.,)	
)	
Appellant,)	FILE AHB-WCA-04-49
)	
From the Decision of)	
)	
THE WORKERS' COMPENSATION INSURANCE)	
RATING BUREAU,)	
)	
Respondent.)	
)	

**ORDER ADOPTING PROPOSED DECISION AND
DESIGNATING DECISION AS PRECEDENTIAL**

A The attached proposed decision of Chief Administrative Law Judge Marjorie A. ATIVE

Rasmussen is adopted as the Insurance Commissioner's decision in the above-entitled matter. However, while we agree that the policyholder herein had no duty to investigate the financial condition of the insurer, we do not want to leave the impression that brokers have no obligations whatsoever to their clients regarding an insurer's financial security. While *Wilson v. All Service Ins. Corp.* (1979) 91 Cal.App.3d 793 remains good law, it would nevertheless be a statutory violation to make a statement as to an insurer's financial security if, in the exercise of reasonable care, a broker should know that statement to be untrue, deceptive or misleading. (Insurance Code section 790.3(b).) Accordingly, in order to insulate him or herself from such a violation, the best practice for a broker is to exercise such reasonable care before representing to a client that an insurer is sound financially.

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PROPOSED DECISION

Introduction

Appellant, Star Roofing Company, Inc. ("SRC") is a California corporation engaged in the business of industrial and commercial reroofing, including roofing repairs and maintenance.¹ Villanova Insurance Company ("Villanova")² insured SRC under workers' compensation insurance policy number WC30526103 for the policy periods

¹ Reporter's Transcript, Vol. 2., p. 343. Henceforth, the reporter's transcript of the evidentiary hearing will be cited as RT, and followed by the page number. Post hearing briefs will be cited as "PHB" and post hearing reply briefs will be cited as "RB", and will be preceded by the name of the party and followed by the page number. Citations to exhibits will be cited as "Exhibit", and will be followed by the exhibit number.

² Villanova was part of the Legion Insurance Group domiciled in Pennsylvania. (RT, pp. 141-142.)

September 1, 1999 through September 1, 2000 (“1999 policy”), and September 1, 2000 through September 1, 2001 (“2000 policy”).

Respondent The Workers’ Compensation Insurance Rating Bureau of California (“WCIRB”) is a rating organization licensed by the Insurance Commissioner under Insurance Code section 11750, et seq., to assist the Commissioner in the development and administration of workers’ compensation insurance classification and experience rating systems. The WCIRB promulgates experience modifications pursuant to the provisions of the California Workers’ Compensation Experience Rating Plan – 1995 (“ERP”) using payroll, premium and claims’ loss data (“experience” or “experience data”) reported by insurers as mandated by the California Workers’ Compensation Uniform Statistical Reporting Plan–1995 (“USRP”).³

Pursuant to Insurance Code section 11737(f),⁴ SRC appeals a decision by the WCIRB affirming its promulgation of SRC’s 2003 experience modification in 2004 without using the experience data developed under SRC’s 1999 and 2000 policies after January 1, 2000, the date of Villanova’s alleged widespread failure to report experience data to the WCIRB.⁵

³ The provisions of the ERP and USRP constitute duly adopted regulations promulgated by the California Insurance Commissioner (Cal. Code of Regs., title 10, §2353). The rules in the ERP and USRP have the same force and effect as statutes. (*Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 10; *Agricultural Labor Relations Bd. v. Superior Court* (1976) 16 Cal. 3d 392, 401.) Since a 2003 experience modification is at issue, the 2003 editions of the ERP and USRP are applicable to this appeal, and all references, unless otherwise stated, are to the 2003 editions of the USRP and ERP.

⁴ Insurance Code section 11737(f) provides in pertinent part: “Every insurer or rating organization shall provide within this state reasonable means whereby any person aggrieved by the application of its filings may be heard by the insurer or rating organization on written request to review the manner in which the rating system has been applied in connection with the insurance offered or afforded . . . Any party affected by the action of the insurer or rating organization on the request may appeal, within 30 days after written notice of the action, to the commissioner . . .”

⁵ The WCIRB also calculated experience modifications for other similarly situated employers without their insolvent insurer data. SRC’s appeal has been designated the lead appeal and all other appeals filed by similarly situated employers have been ordered into abeyance pending the Commissioner’s decision in this matter.

Issues

Based on a review of the evidentiary record, the pre-hearing order issued on August 26, 2004,⁶ and in light of the possibility that this decision may be deemed precedential, in whole or in part, the questions to be determined by the Commissioner are as follows:

1. Is the WCIRB required to exclude experience data reported by Villanova after January 1, 2000, the alleged date of Villanova's widespread failure to report experience data, in calculating SRC's 2003 experience modification?
 - a. When is an insurer insolvent for purposes of applying the provisions of Section III, Rule 3(f) and Section V, Rule 7 of the ERP?
 - b. On what date did the WCIRB receive notice that Legion and Villanova would not timely report experience data to the WCIRB pursuant to the USRP, if not the date of Villanova's widespread failure to report experience data?
2. What experience data does the ERP require the WCIRB to use when calculating an experience modification?
 - a. Should the WCIRB use the experience data proffered by Star Roofing, which was not submitted pursuant to the provisions of the USRP, in calculating SRC's 2003 experience modification?
3. Do grounds exist to grant SRC equitable relief?

⁶ The pre-hearing order issued in this appeal stated the issues as follows:

- “1. Assuming that the WCIRB must follow the instruction of the Insurance Commissioner to exclude all insolvent insurer data from its experience modification calculations, unless such data was submitted prior to the widespread failure to submit data in accordance with the . . . USRP, what is the appropriate date to use as the demarcation of “the widespread failure to submit data in accordance with the USRP”?
2. Is the Appellant's proffered data reliable and otherwise acceptable for use in the calculation of its experience modification for 2003?
3. If the Appellant's particular data, submitted after the “widespread failure” date, is reliable and otherwise acceptable for use in the calculation of its experience modification for 2003, should the WCIRB use that data in its experience modification calculations despite the Insurance Commissioner's instruction? (LEGAL ISSUE for briefing.)”

Parties' Contentions

The WCIRB contends that, in promulgating SRC's 2003 experience modification, the WCIRB correctly excluded experience data reported by Villanova under SCR's 1999 and 2000 policies after January 1, 2000, pursuant to the ERP, the remand order issued in this case and the Commissioner's directive of March 11, 2004.

The WCIRB argues that the Insurance Commissioner directed the WCIRB, by letter dated March 11, 2004, to exclude all insolvent insurer data when promulgating experience modifications that had effective dates beginning from April 1, 2002, to December 31, 2003, unless such data was submitted prior to the insurer's widespread failure to submit data in accordance with the USRP. The WCIRB argues that the evidence proves the date of Villanova's widespread failure to report valid USRP data occurred no later than January 1, 2000.

The WCIRB also contends that the payroll and claims loss experience SRC proffered, in lieu of the experience data Villanova failed to report to the WCIRB pursuant to the USRP, is not reliable or otherwise acceptable for use in calculating SRC's 2003 experience modification. Furthermore, the WCIRB contends that public policy considerations and technical concerns militate against the WCIRB's use of employer-supplied information to promulgate an experience modification in these circumstances.⁷

SCR counters that the Insurance Commissioner's letter of March 11, 2004, was not a directive under Insurance Code section 12921.9 that required the WCIRB to exclude all experience data reported by Villanova under SRC's 1999 and 2000 policies after January 1, 2000. The widespread failure theory adopted by the WCIRB should not,

⁷ WCIRB-PHB, pp. 4-7, 11-15.

therefore, bar the WCIRB's use SRC's 1999 and 2000 experience data in calculating SRC's 2003 experience modification.

SRC argues that the remand orders issued by the Administrative Hearing Bureau ("AHB"), which impacted this and other similar appeals, require the WCIRB to promulgate experience modifications using any other complete and reliable data in place of the experience data that the insolvent insurers failed to report to the WCIRB. SRC contends that the 1999 and 2000 policy experience data it proffered is reliable and should be used by the WCIRB to calculate SRC's 2003 experience modification. Finally, SRC argues that public policy considerations support the use of SRC's proffered experience data in these circumstances.⁸

Procedural History

This appeal was initiated on May 6, 2004. The appeal inception notice was issued on May 10, 2004, and the appeal was assigned to Chief Administrative Law Judge Andrea L. Biren for further proceedings.

The evidentiary hearing was held in San Francisco, California on November 15, and 16, 2004. Attorneys Nicholas P. Roxborough, and Damon M. Ribakoff represented the appellant. Attorneys Thomas E. McDonald, and Barbara E. Wintrup represented the respondent. Present telephonically during a portion of the proceedings was Dean Fishman, Esq., and appellant's witness, Mr. Quist.

At the evidentiary hearing, the parties presented both oral testimony and documentary evidence. Joint Exhibits 1-41 and 45-47, lodged prior to the hearing, and Exhibits 48-49 and 51-53, presented at the hearing, were received and admitted. Exhibits

⁸ SRC-PHB, pp. 1-2, 4-7; SRC-RB p. 15-16.

42-44, 50, and 54-58 were identified, but subsequently withdrawn. The parties filed post-hearing briefs.

This matter was reassigned to ALJ Marjorie A. Rasmussen on January 6, 2005, for post hearing proceedings and decision. The ALJ took official notice of certain documents that had been filed by the California Superior Court in action number BS075861. These documents were marked for identification as ALJ Exhibits 59 and 60, and were admitted into evidence without objection. Notice that the evidentiary record was formally closed was issued on August 19, 2005.

Findings of Fact

A. Background Of The Experience Rating System And The Insolvent Insurer Appeals

It is well established that the financial collapse and eventual insolvency of multiple workers' compensation insurers writing policies in California in recent years threatened the viability of the experience rating system that is administered by the WCIRB. Many employers also were adversely impacted by the multiple insurer insolvencies because the insurers failed to report employer experience data to the WCIRB pursuant to the provisions of the USRP.

1. The Experience Rating System

The legislature has made a policy determination that past claims loss experience of an individual workers' compensation insurance policyholder should be used to forecast future losses by measuring the policyholder's loss experience against the loss experience of policyholders in the same classification to produce an experience-based premium modification factor. Pursuant to Insurance Code section 11734, every workers' compensation insurer must adhere to a uniform experience rating plan that produces

experience modifications applicable to California workers' compensation insurance policies. These modifications must be computed in accordance with the ERP, which is revised yearly. The calculation of an experience modification is based on a defined set of policy year payroll and claims loss data reported by the insurers to the WCIRB in accordance with the rules set out in the USRP.

Under the experience rating system, an employer that meets the payroll requirements for experience rating is issued an experience modification by the WCIRB that is effective on the anniversary rating date ("ARD") of the employer's workers' compensation policy. The experience modification is a percentage that reflects how an insured's workers' compensation premium rate may vary, up or down, from the standard or "normal" rate for the insured's industry, based on the payroll and claims losses of the particular employer insured.

Pursuant to the regulations set forth in the USRP,⁹ insurers report experience data to the WCIRB in Unit Statistical Reports ("USR"). The experience reported to the WCIRB is for the three-year experience period commencing four years and nine months prior to the policy's ARD and terminating one year and nine months prior to that ARD.¹⁰ The first unit statistical report contains exposure, premium and loss information.¹¹ This "experience data" submitted in the USR-1 is valued by the insurer at eighteen (18)

⁹ USRP, Part 4, Section I.

¹⁰ ERP, Section III, Rule 2.

¹¹ USRP Part 4, Section I, Rule 7(a)(b). USRP, Part I, Section II, rule 10, defines "Exposure" as the basis against which losses shall be compared or insurer rates will be applied and, unless otherwise stated, the term means payroll. "Final Premium" is defined as "the total premium charged to the policyholder minus reinsurance assumed, adjustment for reinsurance ceded, retrospective rating adjustments, policyholder dividends, application of deductible credits, and refunds of premium to employers that have instituted successful alternative or modified work vocational rehabilitation plans pursuant to California Labor Code section 4638. (USRP, Part 4, Section II, Rule 11.) "Losses" refer to the various costs and reserves associated with the adjustment of claims submitted under a policy. (*See generally*, USRP, Part 4, Section II.)

months after policy inception, and the USR-1 is due to the WCIRB at twenty (20) months after policy inception. Claims that are still open as of the first USR are required to be valued 12 months later (30 months after policy inception and filed with the WCIRB 32 months after policy inception) in a second USR. An insurer must complete a revaluation of policy experience data and submit subsequent USRs to the WCIRB every twelve months thereafter until all claims are closed or for a total of five unit stat reports.¹² Generally, only experience data contained in the first three unit stat reports submitted under a policy incepting within an experience period are used for experience rating purposes. The WCIRB uses the experience data reported on the group of USRs submitted under each policy during the experience period to calculate an employer's experience modification.

As their financial conditions deteriorated, insurance companies that faced financial difficulties failed to report accurate and timely experience data to the WCIRB. Prior to April 1, 2002, the ERP did not provide any rules for excluding from an experience modification calculation the experience data that an insolvent insurer failed to report in an accurate or timely manner pursuant to the provisions of the USRP. Since the ERP required that an experience modification be based on the entire experience over the three-year experience period, the WCIRB was unable to issue experience modifications for employers whose insurer did not comply with the USRP reporting rules.

Consequently, employers were left with no modification being applied to their premium. Thus, some employers who anticipated receiving a debit experience modification (less than 100%) discovered that they were expected to pay more for their insurance than anticipated while other employers with poor loss experience received a

¹² USRP, Part 4, Section I, Rule 6 and USRP, Part a4, Section VI, Rule 1.

windfall because having no experience modification (equivalent to a 100% modification) meant they paid less for their premium than their safety record warranted.

The Insurance Commissioner responded to this crisis by amending Section III, Rule 3, and Section V, Rule 7 of the ERP, effective April 1, 2002. These “emergency” amendments to the regulations allowed the WCIRB to promulgate an experience modification after the WCIRB received written notice from an insolvent insurer that it would not submit USR experience data in accordance with the USRP. Once the notice was received, the ERP authorized the WCIRB to calculate an experience modification without the missing experience data. The financially troubled insurers failed, however, to provide the required written notice, and the WCIRB remained unable to promulgate experience modifications because the ERP prohibited the WCIRB’s use of partial experience data in the calculation of an experience modification.¹³

¹³ As revised, ERP Section III, Rule 3(f) states, in pertinent part, as follows:

Experience to be Used for Rating California Workers’ Compensation Insurance Risks. The entire California workers’ compensation insurance experience of a risk (except as hereinafter provided) developed under any policy which provides California workers’ compensation insurance coverage for all or a part of the risk’s operations and which incepts within the experience period shall be reported and used in determining its experience modification. . . .

The following experience shall not be used:

- f. Experience of a policy written by an insolvent insurer when such experience is not reported timely in accordance with Part 4, . . . Section 1, Rule 7, of the California Workers’ Compensation Uniform Statistical Reporting Plan-1995, and the WCIRB has been advised in writing by the liquidator or regulator that data will not be submitted for the insolvent insurer.

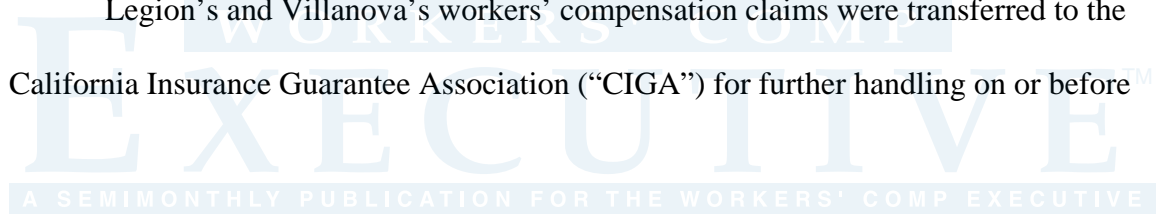
ERP Section V, Rule 7 states:

Experience Modifications Computed Without Data From An Insolvent Insurer. An experience modification computed without experience data described in section III, Rule 3(f), shall not be published after the effective date of the experience modification unless:

2. The Legion And Villanova Insolvencies

The Commonwealth Court of Pennsylvania ordered Legion and Villanova into rehabilitation on March 28, 2002 without a finding of insolvency.¹⁴ Subsequently, on May 3, 2002, the California Insurance Commissioner obtained an order from the Los Angeles County Superior Court in action number BS 075861 that appointed him as ancillary receiver of the two financially troubled insurers pursuant to the authority granted to him under Insurance Code section 1011(d).¹⁵ The purpose of this California superior court action was to enable the Insurance Commissioner to draw upon Legion's and Villanova's California workers' compensation security deposits to pay the insurers' California claims.¹⁶

Legion's and Villanova's workers' compensation claims were transferred to the California Insurance Guarantee Association ("CIGA") for further handling on or before



- (a) The WCIRB was advised in writing by the liquidator or regulator prior to the effective date of the experience modification that data would not be submitted for the insolvent insurer, or
- (b) The experience modification is a revision to a previously published experience modification.

Subsequent revisions to the 2004 ERP eliminated the notice requirement effective January 1, 2004, so that the WCIRB could issue 2004 experience modifications for qualified employers. ERP Section III, Rule 3(f), specifically requires the WCIRB to exclude the following experience when calculating a 2004 experience modification:

f. Experience of a policy written by an insolvent insurer with a required month of valuation on or after the date of liquidation of the insolvent insurer, unless the experience previously was used in a rating and no revaluation is required to be filed pursuant to Part 4, "Unit Statistical Report Filing Requirements," Section VI, Rule 1, of the Uniform Statistical Reporting Plan. (Emphasis added.)

¹⁴ Exhibits 46 and 47.

¹⁵ ALJ Exhibit 59. Insurance Code Section 1011 affords the Insurance Commissioner broad powers to take control of an insurer before it is technically insolvent.

¹⁶ Instead of placing the Legion Group into liquidation, the Pennsylvania Commonwealth Court ordered the Legion Group to stop paying claims in those states that held statutory workers' compensation deposits. California held a security deposit for the Legion Insurance Group in the approximate amount of 140 million dollars. (RT, p. 153.)

November 2002.¹⁷ On May 1, 2003, the WCIRB wrote to Mr. Boyle, the acting President of Legion and Villanova (In Rehabilitation) expressing concern about the deficiencies in the insurers' unit statistical submissions, requesting a detailed explanation for the data deficiencies, and noting that it might become necessary to suspend the issuance of all experience modifications that were based in whole, or in part, on data reported in conjunction with Legion or Villanova policies.¹⁸

Mr. Quist, Senior Vice President of Legion and Villanova (In Rehabilitation) responded to the WCIRB's inquiry by letter on May 7, 2003. Mr. Quist confirmed that California claims filed under policies issued by Legion and Villanova had been transferred to CIGA in November 2002, and since the transfer, the insurer had not received claims loss information from CIGA to update its systems and forward to the WCIRB. Therefore, the unit statistical reports filed since November 2002 did not reflect correct loss information.¹⁹ In response to Mr. Quist's letter, the WCIRB issued industry wide bulletin No. 2003-10 on May 23, 2003, announcing to its members that the WCIRB was suspending the promulgation and issuance of experience ratings based upon unit statistical data submitted by Legion and Villanova.²⁰

The next month, the Los Angeles County Superior Court declared Legion and Villanova insolvent by order dated April 25, 2003, as the workers' compensation security deposit had been depleted.²¹ Three months later the Pennsylvania court, by order of July 28, 2003, declared Legion and Villanova insolvent.²²

¹⁷ Exhibits 28 and 29.

¹⁸ Exhibit 28.

¹⁹ Id.

²⁰ Exhibit 30.

²¹ ALJ Exhibit 60.

²² RT, p. 157.

3. Insolvent Insurer Appeals, The Remand Order Of February 25, 2004, And The Commissioner's Letter Of March 11, 2004

Thereafter, many employers, including SRC, filed appeals with the AHB demanding that the Commissioner order the WCIRB to calculate experience modifications regardless of whether insolvent insurers had provided the requisite notice set forth in the 2003 version of the ERP, and in spite of the ERP's rules mandating that the payroll and loss data be excluded from the experience modification calculation in these circumstances.

On February 25, 2004, a remand order was issued *In the Matter of the Appeal of Star Roofing Company, Inc.* (File Number AHB-WCA-03-83) that addressed the ERP's amended notice requirements. Chief Administrative Law Judge Biren determined that the notice requirement in the ERP was satisfied by constructive notice. The ALJ determined that an insurer's "failure to report accurate, complete and timely" experience data pursuant to the provisions of the USRP constituted constructive notice that the appropriate data would not be reported, thereby satisfying the ERP's notice requirements. The ALJ found that Villanova had given constructive notice to the WCIRB that the missing experience data for SRC would not be regularly reported.²³

The remand order directed the WCIRB to calculate SRC's experience modification(s) "based on the data that was reported in keeping with the USRP and other reliable and complete data, if any, that the WCIRB finds acceptable in lieu of the required reports that are missing."²⁴

²³ Exhibit 38, p. 4. The AHB issued similar remand orders in other appeals in which the WCIRB was a party. (See, Exhibit 39.)

²⁴ Exhibit 38, p. 5.

By letter dated March 8, 2004, the WCIRB sought clarification of the ALJ's remand order from the Insurance Commissioner.²⁵ Specifically, the WCIRB sought to determine: (1) to what extent the remand order would apply to other similarly situated employers; (2) whether an insurer would be considered insolvent for purposes of applying Section III, Rule 3 and Section V, Rule 7 of the ERP when "the appropriate regulator first initiates rehabilitation, conservation, or liquidation of an insurer pursuant to statutory authority and/or judicial order"; and (3) whether the "failure of an insolvent insurer to report accurate, complete, and timely data- on a wide-scale basis in accordance with the provisions of the . . . USRP constitutes the notice specified in Section III, Rule 3 of the ERP such that experience modifications effective between April 1, 2002 . . . and December 31, 2003, that have not been issued should be issued excluding all insolvent insurer data unless such data was submitted prior to the widespread failure to submit data in accordance with the USRP."²⁶

In a letter dated March 11, 2004, the Commissioner confirmed that the interpretation of the rules in the February 25, 2004, remand order was to be applied by the WCIRB to similarly situated employers, and answered the remaining two questions posed by the WCIRB in the affirmative.²⁷

The WCIRB interpreted the Commissioner's March 11, 2004, letter as a directive to exclude all insolvent insurer data from the calculation of those experience modifications held in abeyance unless the insolvent insurer data was reported to the WCIRB prior to the insurer's widespread failure to report accurate, complete and timely

²⁵ Exhibit 39.

²⁶ Exhibit 39.

²⁷ Exhibit 40.

data pursuant to the rules of the USRP.²⁸ The WCIRB then determined that Villanova's widespread failure to report data occurred no later than January 1, 2000, and calculated SRC's 2003 experience modifications without any of the SRC experience data Villanova submitted after that date.²⁹ Following the WCIRB's issuance of a 101% experience modification on April 6, 2004, SRC filed this second appeal.

B. Facts Underlying The SRC Appeal

1. SRC's Operations:

SRC's operations entail commercial re-roofing, repairs and maintenance.

Appellant's service area extends from Sacramento to Monterey and includes the greater San Francisco Bay area.³⁰ Most of SRC's seventy-five employees have been with the company for several years and are experienced in the roofing trade.³¹

SRC has had a safety program in place for approximately twenty years. New employees are given an eight-hour safety-training course followed by a written exam.³² The new hires are initially assigned simple tasks and eventually assume greater levels of responsibility as they gain more experience. SRC holds monthly safety meetings and daily safety checks are conducted on the job sites. Safety materials are regularly handed out to the employees in English and Spanish, and employees are disciplined for violating

²⁸ RT, pp. 35-36.

²⁹ The testimony regarding the basis of the WCIRB's determination of the date of Villanova's widespread failure to report data to the WCIRB is not summarized here. The ALJ finds the evidence offered on Villanova's widespread failure to report data is not relevant based on the ALJ's determination, *infra*, that there is no legal basis for interpreting the Commissioner's letter of March 24, 2003, as a directive concerning what data must be excluded from the calculation of the 2003 experience modification. However, the evidence submitted by the WCIRB on this issue is found in Exhibits 10-14, 18-20-23, 25-26, 28 and RT, pp. 41-42. (*See*, Discussion, *infra*.)

³⁰ RT, p. 343.

³¹ RT, p. 349.

³² RT, pp. 345-347.

proscribed safety procedures.³³ Mr. Clark, the WCIRB's sole witness, conceded that SRC has an "excellent safety record" and this record has been reflected in SRC's debit experience modifications over the last several years.³⁴

The cost of the insurance is a primary consideration in SRC's selection of a carrier.³⁵ Appellant's broker, Jon Heinson, confirmed that he placed SRC with Villanova for the 1999 and 2000 policy periods. Mr. Heinson recommended Villanova because it was an A-rated company by A. M. Best; it had a program through American Patriot that was tailored for the roofing industry; and it had a good third party claims administrator (Cunningham Lindsey).³⁶

2. SRC's 1999 Policy Unit Statistical Reports

The first unit statistical report or USR-1 under SRC's 1999 policy was due in June 2001. Villanova timely submitted a USR-1 on June 5, 2001,³⁷ but it contained estimated payroll data contrary to the rules of the USRP.³⁸ Villanova submitted a corrected USR-1 with final audited payroll data on April 14, 2003, nearly two years after it was due.³⁹

Since all claims were reported closed on the USR-1, no subsequent USRs were due under the 1999 policy as long as all claims reported on the USR-1 remained closed and there were no subsequent loss revisions or correction.⁴⁰

³³ Id.

³⁴ Exhibits 3, 7, 32, 48; RT, pp. 400-401, 448.

³⁵ RT, p. 351.

³⁶ RT, pp. 387-388, 411.

³⁷ RT, p. 456.

³⁸ RT, pp. 456, Exhibit 1. USRP Part 4, Section VI, Rules 1 and 2 authorize a carrier to submit corrected USRs, under certain circumstances, to reflect changes in exposure amounts, classifications and losses. USRP Part 4, Section VI, Rule 2(b)(a) requires "that a correction report must be filed if a final audit has been made of estimated figures previously submitted to the WCIRB." (*Id.*)

³⁹ Exhibit 2.

⁴⁰ Exposure and premium data is included on the USR-1, claims loss data continues to be reported on subsequent USRs as long as a reported claim remains open. (USRP Part 4, Section VI, Rule 1.)

Villanova hired the auditing firm Morrison Insurance Services (“Morrison”) to audit policies on its behalf.⁴¹ Morrison assigned Mr. Buckner to audit SRC’s 1999 policy. Mr. Buckner has over 30 years of experience in the auditing business.⁴² SRC supplied Mr. Buckner with all the documents he needed to complete the audit, including SRC’s payroll registers and quarterly tax reports, payroll tax reports, lists of employees and applicable workers’ compensation classification codes. The audit was completed on February 1, 2001, five months after the 1999 policy expired.⁴³ Mr. Buckner testified that his audit was based on actual payroll figures; not estimated figures.⁴⁴ Pursuant to his company policy, Mr. Buckner submitted the audit to Morrison within two weeks after it was completed.⁴⁵ Morrison then conducted an internal review of the audit to check for any errors before sending the audit information to Villanova. The appellant’s Controller, Mr. Burke, also reviewed the 1999 audit figures and determined there were no errors.⁴⁶ No evidence was presented to explain why Villanova submitted estimated payroll data to the WCIRB in June 2001 instead of the actual payroll data developed in Mr. Buckner’s audit.

The WCIRB contends that the 1999 payroll data reported by Villanova is problematic. Mr. Clark testified that even the corrected 1999 payroll data submitted by Villanova on April 14, 2003, was suspect because it was submitted to the WCIRB two years after it was due. However, the WCIRB offered no specific evidence that the 1999 audit completed by Mr. Buckner contained errors, and Mr. Clark later conceded that the

⁴¹ RT, p. 418.

⁴² RT, p. 415.

⁴³ Exhibit 16; RT, p. 424.

⁴⁴ RT, pp. 366-369; 418-419.

⁴⁵ RT, p. 424.

⁴⁶ RT p. 369.

payroll audit figures were accurate.⁴⁷ Mr. Clark also admitted that the resubmitted 1999 payroll was used in the calculation of SRC's 2002 experience modification issued on April 18, 2003, and that the only reason that the corrected 1999 payroll figures were not used in the calculation of SRC's 2003 modification was because of the April 1, 2002, rule change prohibiting the use of late reported data.⁴⁸ Based on the foregoing testimony, the ALJ finds that the weight of the evidence proves that the corrected 1999 audited payroll figures submitted by Villanova on April 14, 2003, are accurate as set forth in Exhibits 2 and 16.

The WCIRB also disputes the accuracy of SRC's 1999 claims data. Mr. Clark testified at length about Villanova's widespread failure to report accurate and timely data to the WCIRB over a period of years on various policies, none of which were specifically identified by policy number or related to SRC.⁴⁹ According to the WCIRB witness, the claims loss data on SRC's 1999 policy was suspect because the amount of losses reported under the policy was low in comparison to the amount of premium generated.⁵⁰

However, the WCIRB did not present specific evidence to contradict the claims loss data submitted on SRC's 1999 policy, and the WCIRB did not submit any evidence proving that the claims reported as closed under the 1999 policy had been re-opened.

⁴⁷ RT, pp. 442-447, 458-465.

⁴⁸ ERP Section V, Rule 6 authorizes the WCIRB to issue a revised experience modification in the event of the discovery of an error in a current experience modification or the two immediately preceding experience modifications. On or about March 27, 2003, Villanova submitted a correction to SRC's 2000 policy USR-1. Subsequently, on April 14, 2003, Villanova forwarded to the WCIRB a correction to the USR-1 it previously submitted on SRC's 1999 policy. The record reveals that the WCIRB issued SRC a revised 2002 experience modification effective April 18, 2003, the date it was published, using the corrected USR-1 data Villanova submitted on the 1999 and 2000 policies pursuant to ERP Section V, Rule 6(b), an ERP provision that was not impacted by the April 1, 2002, revisions. RT, pp. 274, 339-340; Exhibit 48; ERP, Section III, Rule 3, and Section V, Rule 7.

⁴⁹ RT, pp. 41-42, 56-63, 78, 330, 332.

⁵⁰ WCIRB PHB, p. 13.

Mr. Clark conceded that, in this particular case, he had no evidence that the third party administrator mishandled or improperly reserved SCR's 1999 claims.⁵¹ While Mr. Clark opined that the closed 1999 claims could re-open at some point in time, he conceded that all the 1999 claims were reported closed on the initial June 2001 USR-1 and a second USR would not have been required.⁵² Mr. Clark admitted that he had no knowledge that any of the 1999 claims reported as closed had, in fact, been re-opened.⁵³ Moreover, the WCIRB used the claims loss reported under SRC's 1999 policy to calculate SRC's revised 2002 experience modification issued on April 18, 2003.⁵⁴

Appellant's witnesses were more persuasive. Mr. Quist testified that while Legion and Villanova were not receiving data on any open California claims after November 2002, he believed the data on all claims that were closed prior to November 2002 was accurate.⁵⁵ Mr. Heinson, who was familiar with SRC's policies and losses, testified that all claims filed under the 1999 policy were accurately reported and closed.⁵⁶

Based on the foregoing, the ALJ finds that the appellant's evidence with respect to SRC's 1999 claims loss data is more credible than the evidence presented by the WCIRB. Accordingly, the ALJ finds that: (1) all claims for workers' compensation benefits filed under SRC's 1999 policy were closed by June 1, 2001, (2) the claims loss data that was first reported in the USR-1 Villanova submitted in June 2001 was accurate, and (3) the corrected USR-1 submitted to the WCIRB in April 2003, though late, was accurate as well. (Exhibits 2 and 48.)

⁵¹ RT, p. 465.

⁵² RT, p. 456. USRP Part 4, Section I, Rule 7.

⁵³ RT, pp. 457, 465.

⁵⁴ Exhibit 48.

⁵⁵ RT, p. 157.

⁵⁶ RT, pp. 390-392; Exhibit 42

3. The 2000 Policy Audit And Experience

Pursuant to the USRP, Villanova was required to file a USR-1 on the 2000 policy in June 2002 and, if any claims remained open on the USR-1, a USR-2 was due a year later in June 2003. The USR-2 experience data would be used by the WCIRB to calculate SRC's October 1, 2003 experience modification.⁵⁷

Villanova timely submitted the 2000 USR-1 on May 21, 2002, but it contained estimated payroll data and not all claims were reported closed.⁵⁸ Following the payroll audit on August 26, 2002, Villanova submitted a corrected USR-1 to the WCIRB on March 23, 2003, nearly a year late.⁵⁹ Since all claims were not reported closed on the USR-1, Villanova was required to submit a USR-2 in June 2003. Instead, experience data for the USR-2 was submitted to the WCIRB by cover letter from Ms. Krause, a clerk at Legion, rather than by electronic transmission or hard copy pursuant to the rules of the USRP on September 11, 2003, two months late, and after the issuance of the California and Pennsylvania liquidation orders.⁶⁰

There is no dispute that Mr. Buckner completed his 2000 payroll audit of SRC's policy after the first USR was due. However, the WCIRB did not present any evidence that proved Mr. Buckner's 2000 payroll audit was inaccurate because it was completed late. In fact, Mr. Clark admitted that he did not doubt the accuracy of Mr. Buckner's 1999 and 2000 audits.⁶¹ As previously noted, the WCIRB also used SRC's corrected 2000 payroll data to calculate SRC's revised 2002 experience modification issued on

⁵⁷ RT, p. 450.

⁵⁸ RT, pp 448-451; Exhibit 5.

⁵⁹ RT, p. 449; Exhibits 4, 24.

⁶⁰ Id., Exhibits 6, 33; ALJ Exhibit 60.

⁶¹ RT, pp. 458-465.

April 18, 2003.⁶² Accordingly, the ALJ finds that the 2000 audited payroll figures set forth in the corrected USR-1 Villanova submitted on March 23, 2003, are correct as set forth in Exhibits 4 and 48.

While SRC presented credible evidence regarding the accuracy of its 2000 payroll audit, the same cannot be said for the evidence SRC offered regarding its 2000 claims loss data. After Legion's and Villanova's claim files were transferred to CIGA for further handling in November 2002, Mr. Quist's undisputed testimony confirms that the insurers stopped receiving claims loss data on the open claims.⁶³ Thus, Legion and Villanova were unable to submit complete and accurate unit statistical reports to the WCIRB.⁶⁴ Legion and Villanova stopped reporting experience data altogether to the WCIRB after the WCIRB notified the industry on May 23, 2003, that the WCIRB was suspending its promulgation and issuance of experience modifications based upon unit statistical reports from Legion and Villanova.⁶⁵

SRC's USR-2 was due in June 2003 approximately seven months after Villanova stopped receiving claims loss data from CIGA. However, on September 11, 2003, after the WCIRB's May 2003 bulletin and the entry of the California and Pennsylvania liquidation orders in April and July 2003 against Legion and Villanova, Ms. Krause sent the WCIRB a letter with a copy of the 2000 USR-2 for SRC.⁶⁶

The cover letter of September 11, 2003, which accompanied the USR-2, states that the losses "are correct per our loss code query."⁶⁷ However, Ms. Krause, was not

⁶² Exhibit 48.

⁶³ Mr. Quist confirmed that both Legion and Villanova utilized the same personnel to perform various functions related to data reporting. (RT, p. 177.)

⁶⁴ RT, pp. 154-155.

⁶⁵ RT, pp. 172-173.

⁶⁶ Exhibit 33.

⁶⁷ Id.

available to testify at the hearing concerning the basis of her opinion that the data was correct. Whether she was qualified to make this assessment concerning the accuracy of the data is doubtful. Based on Mr. Quist's testimony, Ms. Krause's duties at Legion are primarily clerical - she sends out unit stat reports or confirms that they are sent out.⁶⁸ When Mr. Quist was asked why Ms. Krause might have sent the USR-2 on SRC's 2000 policy to the WCIRB, he stated his belief that the WCIRB might make an exception to the policy statement in its bulletin, and promulgate an experience modification for an employer if Villanova provided data to the WCIRB after May 23, 2003.⁶⁹ Mr. Quist could not think of any reason why Ms. Krause would have sent a USR-2 to the WCIRB if she thought the WCIRB would ignore it. Mr. Quist did not offer any testimony regarding the accuracy of the 2000 USR-2 report.

No evidence was offered regarding (1) how or when Villanova received the claims loss data; (2) whether it came from CIGA or a third party administrator; (3) what internal checks Villanova conducted on the claims loss data given that the company had been liquidated before the data was sent to the WCIRB; and (4) whether the data was accurate. Accordingly, the ALJ does not find the USR-2 submitted on September 11, 2003, reliable.

In lieu of using the USRs due under the 2000 policy, SRC offered into evidence a loss run that was prepared on SRC's behalf in February 2003. However, the appellant's witnesses, Ms. Robin Brooks-Gooding and Mr. Heinson, admitted that they had no personal knowledge about how the claims under the 2000 policy were adjusted or by

⁶⁸ RT, p. 141.

⁶⁹ RT, pp. 173, 186.

whom.⁷⁰ Thus, neither witness was able to verify the accuracy of the loss run proffered by the appellant at the time the document was created.

Claims adjusting is an ongoing process, and claims data changes as claims are opened, paid and the reserves changed to reflect potential exposure. A loss run is a document that lists the reported claims data under a policy on the date the loss run is created. If the reported data is incomplete or inaccurate, the loss run is likewise inaccurate. Based on the foregoing, the ALJ finds that the loss run evidence proffered by SRC is not credible evidence of SRC's claim losses under its 2000 policy.

4. The WCIRB's Inability To Analyze Other Types Of Experience Data Not Reported By Insurers Pursuant To The USRP.

After insurers failed to timely and accurately report employer experience data pursuant to the provisions of the USRP, many employers, including SRC, asked the WCIRB to substitute raw data such as payroll audits and claims loss runs generated by third parties on behalf of the employer in lieu of USRs as the basis for calculating the employers' experience modifications.

However, raw experience data has not gone through the typical error checks and balances of an insurers' internal system before being converted into a USR and sent to the WCIRB.⁷¹ The raw experience data typically comes in various formats, and contains different levels of experience information.⁷² According to Mr. Clark's uncontested testimony, the WCIRB's staff is not skilled in analyzing raw experience data and converting it into the unit statistical format required by the USRP.⁷³

⁷⁰ RT, pp. 390-392; 4432-437; Exhibit 43.

⁷¹ RT, p. 454.

⁷² RT, p. 453

⁷³ Id.

Based on the forgoing, the ALJ finds that the staff at the WCIRB does not have the knowledge and technology to convert the raw experience data proffered by SRC into the USR format mandated by the USRP.

Discussion

The principle question underlying the issues on appeal is what experience data should the WCIRB use to calculate SRC's 2003 experience modification in light of Villanova's failure to timely report experience data to the WCIRB pursuant to the provisions of the USRP.

A. The WCIRB Is Not Required To Exclude All Experience Data Reported By Villanova After January 1, 2000, The Alleged Date Of Villanova's Widespread Failure To Report Experience Data Pursuant To The Provisions Of The USRP.

1. The Remand Order of February 25, 2004, and the Commissioner's Letter of March 11, 2004

The February 25, 2004, remand order holds that the notice requirement in Section III, Rule 3(f) and Section V, Rule 7 of the ERP is satisfied by constructive notice, and an insurer's failure to report accurate, complete and timely experience data pursuant to the provisions of the USRP constitutes constructive notice that the appropriate data will not be reported. The remand order found that the WCIRB received constructive notice of Villanova's failure to report experience data pursuant to the USRP and directed the WCIRB to calculate SRC's 2003 experience modification based on the data that was reported in keeping with the USRP and other reliable and complete data, if any, that the WCIRB found acceptable in lieu of the required reports that were missing.⁷⁴

The remand order, however, did not specify the date on which the WCIRB received constructive notice of Villanova's failure to report experience data, and did not

⁷⁴ Exhibit 38.

provide a methodology for the WCIRB to use in determining the date it received constructive notice. Subsequently, the WCIRB sought clarification of the content and scope of the remand order. Due to the WCIRB's concerns about Villanova's experience data reporting prior to its liquidation, the WCIRB asked the Commissioner to confirm whether the date of an insolvent insurer's widespread failure to report data accurately, completely and timely pursuant to the USRP would constitute the notice required under Section III, Rule 6(f) and whether all experience data submitted after the date of widespread failure should be excluded from the experience modification calculation.

The Commissioner's affirmative reply to the WCIRB's letter inquiry indicates his concern about tainting the pool of data collected by the WCIRB with unreliable data from the now insolvent insurers, and the Commissioner's willingness to allow the WCIRB some latitude in its administration of the experience rating plan in light of the difficulties posed by the insolvent insurer problem. In his March 11, 2004, letter the Commissioner confirms that: (1) the interpretation of the rules cited in the February 25, 2004, remand order is to be applied by the WCIRB to similarly situated employers; (2) an insurer would be considered insolvent for purposes of applying Section III, Rule 3 and Section V, Rule 7 of the ERP when the appropriate regulator first initiates rehabilitation, conservation, or liquidation of an insurer pursuant to statutory authority and/or judicial order; (3) the failure of an insolvent insurer to report accurate, complete, and timely data pursuant to the rules of the USRP constitutes the notice specified in Section III, Rule 3 of the ERP, and (4) experience modifications effective between April 1, 2002, and December 31, 2003, that have not been issued should be issued excluding all insolvent insurer data

unless such data was submitted prior to the widespread failure to submit data in accordance with the USRP.⁷⁵

The parties dispute the legal significance of the Commissioner's letter. However, the law is clear on this issue. According to Insurance Code section 12921.9:

(a) A letter of legal opinion signed by the Commissioner or the Chief Counsel of the Department of Insurance that was prepared in response to an inquiry from an insured or other person or entity and that discusses either generally or in connection with a specific fact situation the application of the Insurance Code or regulations promulgated by the commissioner shall be made public. . . .

(b) A letter or legal opinion made public pursuant to this section shall not be construed as establishing an agency guideline, criterion, bulletin, manual, instruction, order, standard of general application, rule, or regulation, as those terms are described in Sections 11340.5 and 11342.60 of the Government Code.

As a matter of law, therefore, the Commissioner's March 11, 2004, letter may offer guidance to the WCIRB, but it cannot be used as legal support for the WCIRB's course of action in determining the date of each insolvent insurer's widespread failure to report data to the WCIRB. In fact, the WCIRB does not argue otherwise.

Rather, in support of its position, the WCIRB points out the inherent difficulties in ignoring the Commissioner's guidance, and notes that even the pre-hearing order in this matter designated the determination of the widespread failure date as the first issue in this proceeding.⁷⁶ Yet, the pre-hearing order also required the parties to initially resolve the legal issue of whether the Commissioner's letter must be followed. SRC's arguments are more persuasive on this issue. The ALJ concludes that the WCIRB was not legally required to determine the date of an insolvent insurer's widespread failure for purposes of

⁷⁵ Exhibit 40.

⁷⁶ WCIRB RB, pp. 1-2.

excluding experience data from a rating calculation as a matter of law, and that an insurer's date of widespread failure to report "accurate, complete, and timely",⁷⁷ experience data does not necessarily constitute the date of constructive notice pursuant to the remand order.

Nevertheless, by applying the rules of the ERP to the facts in this case, the WCIRB correctly excluded the experience data reported by Villanova related to SRC's 1999 and 2000 policies.

2. Interpretation Of Applicable Provisions Of The ERP And Their Application To The Underlying Facts In The SRC Appeal

The ERP, as revised on April 1, 2002, permits the WCIRB to calculate an employer's experience modification without all experience data from the relevant experience period only when the following conditions are met: (1) the policy is written by a now insolvent insurer, (2) the experience is not reported timely in accordance the USRP, and (3) the liquidator or regulator has advised the WCIRB in writing that experience data will not be submitted for the insolvent insurer.

ERP Section III, Rule 3(f) states, in pertinent part, as follows:

Experience to be Used for Rating California Workers' Compensation Insurance Risks. The entire California workers' compensation insurance experience of a risk (except as hereinafter provided) developed under any policy which provides California workers' compensation insurance coverage for all or a part of the risk's operations and which incepts within the experience period shall be reported and used in determining its experience modification. . . .

The following experience shall not be used:

- f. Experience of a policy written by an insolvent insurer when such experience is not reported timely in

⁷⁷ Exhibits 38 and 39.

accordance with Part 4, . . . Section 1, Rule 7, of the California Workers' Compensation Uniform Statistical Reporting Plan-1995, and the WCIRB has been advised in writing by the liquidator or regulator that data will not be submitted for the insolvent insurer.

The express written notice requirement also is contained in Section V, Rule 7 of the ERP which mandates that an experience modification calculated without data as described in ERP Section III, Rule 3(f) shall not be published by the WCIRB after the effective date of the experience modification unless:

- (a) The WCIRB was advised in writing by the liquidator or regulator prior to the effective date of the experience modification that data would not be submitted for the insolvent insurer, or
- (b) The experience modification is a revision to a previously published experience modification.

The April 1, 2002, revisions to the ERP did not include a definition of the term "insolvent insurer" and, as previously noted, the revised ERP is silent on how the WCIRB should promulgate experience modifications when an insolvent insurer fails to submit experience data in accordance with the USRP, but the regulator or liquidator fails to give the required written notice that neither the insolvent insurer nor the regulator or liquidator will comply with the USRP's reporting requirements.

The Commissioner determined, in his letter of March 11, 2004, that an insurer is insolvent under the ERP when the appropriate regulator first initiates rehabilitation, conservation, or liquidation of an insurer pursuant to statutory authority and/or judicial order.⁷⁸ The ALJ finds that the Commissioner's definition of an insolvent insurer is reasonable.

⁷⁸ Exhibit 40.

Insurance Code section 985 defines “insolvency” as follows:

(a) On or after January 1, 1970, as used in this article and in subdivision (i) of Section 1011, “insolvency” means either of the following:

(1) Any impairment of minimum “paid-in capital” or “capital paid in,” as defined in section 36, required in the aggregate of an insurer by the provisions of this code for the class, or classes, of insurance that it transacts anywhere.

(2) An inability of the insurer to meet its financial obligations when they are due. (Emphasis added.)

In California, “conservation”⁷⁹ occurs when the Insurance Commissioner, upon a superior court’s order, takes over the operations of an insurance company licensed to do business in California. Typically, a conservation order is issued because the insurance company is insolvent, and the Commissioner must operate the company in order to conserve assets for the benefit of policyholders, creditors and other persons interested in the assets of the company. One of the Commissioner’s main duties, during conservation, is to conduct a thorough examination of the insurance company’s books and records to determine whether the company can be rehabilitated so that it may continue operating without the management by the Commissioner. (Insurance Code sections 1057-1059.)

Liquidation is the process whereby the Commissioner, upon a superior court’s order, terminates an insurance company’s insurance business after the Commissioner has determined that the insurance company cannot be rehabilitated and that it would be futile to continue with the conservation. (Insurance Code sections 1016 and 1017.)

In addition to insolvency, Insurance Code section 1011 specifies certain acts of delinquency that may constitute grounds for the Commissioner’s right to take control of

⁷⁹ Other states obtain orders of rehabilitation based on similar grounds.

an insurance company. Insurance Code section 1011(d) permits that Commissioner to apply for an order of conservation when an insurer is in a condition that renders its further transaction of business “hazardous to its policyholders, its creditors, or the public.” (*Id.*) The order appointing the Commissioner as ancillary receiver over Legion and Villanova’s California assets was based on the Pennsylvania rehabilitation order and Insurance Code section 1011(d).⁸⁰ After obtaining the court order, the Commissioner utilized his statutory authority to draw upon the Legion and Villanova’s security deposits to pay the insurers’ California claims since these carriers were not able to honor their California financial obligations when they became due. As such, Legion and Villanova were insolvent pursuant to the definition of insolvency contained in Insurance Code section 985(a) (2).

Accordingly, the ALJ holds that an insurer is insolvent for purposes of applying the rules of the ERP when the appropriate regulator first initiates rehabilitation, conservation, or liquidation of an insurer pursuant to statutory authority and/or judicial order. In this case, the ALJ holds that Legion and Villanova were insolvent for purposes of applying the regulations of the ERP and USRP as of May 3, 2002, the date of the California Superior Court’s order appointing the Commissioner as ancillary receiver of the insurance companies.

With respect to the issue of notice under the ERP, the ALJ concurs with the findings in the remand order issued on February 25, 2004, that a reasonable interpretation of the ERP’s notice requirement allows for constructive notice in lieu of written notice to

⁸⁰ An order of conservation is issued against an insurer domiciled in California. Legion and Villanova were domiciled in Pennsylvania. Thus, the California conservation proceedings against these two insurance companies was somewhat truncated in that the Commissioner sought to be appointed as ancillary receiver over all of Legion and Villanova’s California assets. The Pennsylvania Rehabilitation Order, however, specifically declined to find the carriers insolvent.

trigger the WCIRB's calculation of an experience modification. Accordingly, the ALJ finds that the ERP constructive notice requirement is met on the date the appropriate regulator first initiates rehabilitation, conservation, or liquidation of an insurer pursuant to statutory authority and/or judicial order if at that time USRs are delinquent, and otherwise as soon thereafter as USRs are delinquent, and the regulator or liquidator has not indicated USRs are forthcoming. Clearly, the WCIRB is put on notice that an insurer's ability to timely and accurately report experience data to the WCIRB is significantly compromised when an out-of state regulator or the California Insurance Commissioner initiates rehabilitation or conservation proceedings against that insurer. In the instant matter, the ALJ finds that the WCIRB received constructive notice that Legion and Villanova were not going to report experience data pursuant to the USRP on May 3, 2002, the date of the California Superior Court's order appointing the Commissioner as ancillary receiver of the insurance companies. Based on the foregoing, the three factors needed to trigger the calculation of an experience modification under Section III, Rule 3(f) are met.

B. The ERP Mandates That The WCIRB Exclude Experience Data Not Reported Pursuant To The Provisions Of The USRP From The Calculation Of SRC's 2003 Experience Modification

1. Experience Period Applicable To SRC's 2003 Experience Modification

The calculation of an experience modification begins with identifying the policies that incept within the three-year experience period. ERP Section III, Rule 3, requires that, with exceptions, the WCIRB must use the experience from all policies that incept during the experience period.

ERP Section III, Rule 2, “Experience Period,” defines the experience period as follows:

The experience period shall be three (3) years, commencing four (4) years and nine (9) months prior and terminating one (1) year and nine (9) months prior to the date for which an experience rating is to be established.

Hence, with respect to SRC’s October 1, 2003 experience modification, the WCIRB must review the experience from all SRC’s policies listed below that inception during the experience period from January 1, 1999 to January 1, 2002:

Insurer	Policy Number	Inception Date
Villanova Insurance. Co.	WC30526103	September 1, 1999
Villanova Insurance Co.	WC30526103	September 1, 2001
State Compensation Insurance Fund	713-00-7901	September 1, 2002
State Compensation Insurance Fund	713-00-7901	October 1, 2002

2. Calculation Of SRC’s 2003 Experience Modification

Once the set of policies has been identified for the experience period, the WCIRB must use the appropriate policy year data in the experience rating calculation. ERP Section VI, *Tabulation of Experience*, Rule 1, states that:

Data Used for Experience Rating. The data used for experience rating purposes shall be the individual risk experience data reported in accordance with the provisions of the Uniform Statistical Reporting Plan on every policy that, in accordance with Section III, Rule 3, “Experience to be Used for Rating California Workers’ Compensation Insurance Risks,” is to be used in determining the experience modification. Except as specifically provided in this Section, the data used shall be the data reflected in the latest unit statistical report (first, second or third), which, in accordance with the Uniform Statistical Reporting Plan,

was due to be filed with the Bureau no later than one month prior to the effective date of the experience rating.
(Emphasis added.)

Insurers must value and report experience data to the WCIRB according to the rules set out in the USRP. Part 4, Section IV of the USRP provides the rules for reporting payroll experience to the WCIRB. Under this section, insurers are required to report audited payroll experience to the WCIRB.⁸¹ The rules governing the type of claims loss data required in a USR are set forth in Part 4, Section V of the USRP.

The USRP at Part 4, Section 1, delineates the time frames for valuing policies and filing experience data with the WCIRB. As previously noted, policies are first valued at eighteen (18) months after policy inception. The 18 months period prior to the first policy evaluation allows time for insurers to complete a physical audit of a policyholder's payroll, to capture most of the claims for benefits submitted under a policy and to place an initial value on each claim.⁸² Insurers must file subsequent unit stat reports if one or more claims on a first, second, third or fourth unit stat report have been: (1) previously reported as open or resolved; (2) incurred but not reported, (3) previously reported as closed but are re-opened or resolved, or (4) previously reported as closed but have been reopened and re-closed with the incurred indemnity or medical amounts different from the last reported amounts.⁸³

SRC was insured under four policies during the experience period relevant to the calculation of its 2003 experience modification. Only the Villanova policies are at issue

⁸¹ See also, USRP, Part 4, Section II, Rule 3. When it is not possible to obtain audited payroll exposure figures, the insurer "shall submit a signed statement indicating the reasons why audited exposure figures cannot be obtained." USRP, Part 4, Section III, Rule 22.

⁸² USRP, Part 4, Section I, Rule 6. Workers' compensation policies are no longer than one year. Thus, insurers have at least six (6) months to complete a payroll audit after policy expiration.

⁸³ USRP, Part 4, Section VI, Rule 1

here. Based on the foregoing, the 1999 Villanova policy would be valued for the first time in April 2001, and the 2000 Villanova policy would be initially valued in April 2002.

USRP Part 4, Section 1, Rule 7 specifies that experience data be reported to the WCIRB within two months of the date of valuation. This allows time for the WCIRB to publish the experience modification prior to the effective date, and to audit the loss data in the event the WCIRB determines the USR contains errors. Hence, the audited payroll and claims loss data developed under SRC's 1999 policy valued in April 2001 would be reported to the WCIRB in June 2001. Similarly, the audited payroll and claims loss data developed under SRC's 2000 policy valued in April 2002 would be reported to the WCIRB in June 2002. The chart below illustrates the experience period for SRC's 2003 experience modification and the valuation and reporting due dates. The chart also indicates the dates on which Villanova actually submitted the USR data to the WCIRB.

	1999	2000	2001
Insurer	Villanova	Villanova	State Fund
Policy Dates	September 1, 1999	September 1, 2000	September 1, 2001 October 1, 2002
USR-1	<u>Valuation:</u> April 2001 <u>USR-1 Due:</u> June 2001 <u>Submitted:</u> June 2001 <u>Correction:</u> April 2003 prior to liquidation. No open claims reported. Used to calculate revised 2002 experience modification	<u>Valuation:</u> April 2002 <u>USR-1 Due:</u> June 2002 <u>Submitted:</u> June 2002 <u>Correction:</u> March 2003 prior to liquidation. Open claims reported. Used to calculate revised 2002 experience modification.	<u>Sept. Policy:</u> <u>Valuation:</u> April 2003 <u>USR-1 Due:</u> June 2003 <u>October Policy:</u> <u>Valuation:</u> May 2003 <u>USR-1 Due:</u> July 2003
USR-2	<u>Valuation:</u> April 2002 <u>USR-2 Due:</u> June 2002 USR-2 not required if no open claims	<u>Valuation:</u> April 2003 <u>USR-2 Due:</u> June 2003 <u>Submitted:</u> September 11, 2003 after liquidation	N/A
USR-3	<u>Valuation:</u> April 2003 <u>USR-3 Due:</u> June 2003 USR-3 not required if no open claims.	N/A	N/A

Pursuant to ERP Section VI, Rule 1, the WCIRB would use the experience data developed under the four policies incepting during the experience period and reported by Villanova and State Fund in the USRs submitted June 2003 and July 2003 (the latest USRs due before the effective date of the experience modification being issued) to calculate SRC's 2003 experience modification.⁸⁴

Villanova filed a first level USR with the WCIRB on the 1999 policy when it was due on June 2001. However, while all claims were reported closed, the USR-1 data was incomplete because the payroll experience was estimated rather than audited. Approximately two years later, on April 14, 2004, Villanova submitted a correction to the 1999 USR-1 that provided the WCIRB with audited 1999 payroll information.

The USR-1 Villanova submitted under SRC's 2000 policy also was incomplete. Once again, the 2000 policy payroll experience was estimated rather than audited. Villanova submitted audited 2000 payroll data to the WCIRB in March 2003, nearly a year later. Since Villanova had reported that claims remained open on its 2000 USR-1, a second valuation and USR filing was due on June 2003. Villanova failed to timely submit the USR-2 required under this policy.

ERP Section III, Rule 3 provides that the WCIRB has the discretion to verify all exposure data that is to be used in the calculation of an experience modification. Under the facts in this case, the WCIRB correctly determined that the payroll experience Villanova submitted in the 1999 USR-1 was based on estimates that could not be used in

⁸⁴ Under the facts in this case, the USR-1 experience data from the 2001 State Fund policies, and the USR-2 experience data from the 2000 Villanova policy would have been used to calculate SRC's 2003 experience modification since these USRs were due to be filed with the WCIRB in June 2003. As long as the claims reported closed on the USR-1 under the 1999 policy remained closed, no further USR would be required. Thus, the USR-1 experience data from the 1999 Villanova policy also would be used to calculate SRC's 2003 experience modification.

the calculation of SRC's experience modification. Furthermore, ERP Section III, Rule 3(f) prohibits the WCIRB's use of USRs that are reported late on policies issued by now insolvent insurers. The 1999 audited payroll data on the 1999 policy due under the USR-1 was reported 2 years late. The second unit stat report required on the 2000 policy also was submitted late. Accordingly, the WCIRB properly excluded the experience data developed under SRC's 1999 and 2000 policies from the calculation of SRC's 2003 experience modification.

3. The Remand Order of February 25, 2004, Does Not Require the WCIRB To Calculate An Experience Modification Using Experience Data That Has Not Been Submitted Pursuant To The Provisions Of The USRP

SRC contends that the February 25, 2004, remand order requires the WCIRB to recalculate SRC's 2003 experience modification using the reliable and complete experience data submitted by SRC in lieu of Villanova's missing unit statistical reports. Since the legislative intent with respect to the experience rating plan as set forth in Insurance Code section 11736⁸⁵ is to provide incentives for loss prevention and to encourage safety, SRC argues that public policy considerations support the use of SRC's payroll and claims data. SRC contends it was not its fault that Villanova went into liquidation and that CIGA failed to provide experience data to Villanova. Yet, SRC argues, the WCIRB's decision to exclude all SRC's experience data "punishes SRC for the acts of Villanova and CIGA" and is contrary to the legislative intent of the experience rating plan because the WCIRB's decision disregards SRC's proven good safety record.⁸⁶

⁸⁵ Insurance Code section 11736 states: "An experience rating plan shall contain reasonable eligibility standards, provide adequate incentives for loss prevention, and shall provide for sufficient premium differentials, so as to encourage safety."

⁸⁶ SRC's PHB, pp. 3-8; SRC's RB, pp. 2-10, 15.

The WCIRB counters that SRC has not proven its data is reliable. The WCIRB also cites several technical reasons that preclude its use of employer-supplied data, such as: (1) employers do not have mechanisms to provide subsequent unit statistical reports, revisions or corrections of losses as required by the USRP and/or ERP, and; (2) the information provided in loss runs varies among insurers and does not provide the same type of data that the USRP requires on unit statistical reports.⁸⁷

The WCIRB also contends that public policy considerations militate against the WCIRB's use of employer-supplied information in that: (1) using information provided by an individual employer may adversely impact other employers if they are required to fund a reduction in premium for those employers that successfully protest and receive lower experience modifications by using inherently unverifiable but favorable data; (2) since the ERP is designed to treat all employers in a non-discriminatory fashion, permitting some employers to provide their own loss data that will affect their premium calculation is not consistent with the policy against non-discrimination in rates and rating plans pursuant to Insurance Code section 11732.5;⁸⁸ and (3) without the ability to process data through its normal method of operations, the WCIRB loses its ability to evaluate the credibility of the data it uses to promulgate experience modifications, thereby compromising the reliability of the rating information produced by the WCIRB, contrary to its statutory purpose under Insurance Code section 11750.3(a).⁸⁹

⁸⁷ WCIRB PHB, p. 17.

⁸⁸ Insurance Code section 11732.5 provides as follows: "Rates shall not be unfairly discriminatory. Rates are unfairly discriminatory if, after allowing for practical limitations, price differentials fail to reflect equitably the difference in expected losses and expenses. A rate of an insurer shall not be deemed unfairly discriminatory because different premiums result for policyholders with like loss exposures but different expenses, or like expenses but different loss exposures, as long as the rate reflects the differences with reasonable accuracy."

⁸⁹ WCIRB PHB, p. 16; Insurance Code section 11750.3 states as follows: "A rating organization may be organized pursuant to this article and maintained in this state for the following purposes: (a) To provide

The ALJ concludes that the WCIRB's arguments are persuasive, and are supported by the facts, the law and public policy. Based on the weight of the evidence, the ALJ has already found that the loss runs submitted by SRC are not accurate or reliable measurements of SRC's loss experience and cannot serve in lieu of unit statistical reports. The loss runs do not comport with the requirements set forth in the USRP and the WCIRB cannot properly convert the incomplete raw data in the loss runs into a form that is compatible with the format requirements of the USRP and ERP.

The ERP authorizes the WCIRB to "verify any or all of the data from which the experience is to be determined."⁹⁰ Thus, the WCIRB ultimately has the authority to determine whether data submitted by an insolvent insurer is reasonably verifiable for use in the experience modification calculation. As the WCIRB correctly notes, the problem with allowing employer supplied data, even arguably reliable data, is that it is only the positive data that will be submitted. Employers who have not been adversely impacted by the publication of an experience modification are not appealing. Because the overall rating system must remain premium neutral, to the extent there is a significant level of favorable data reported by allowing exceptions to the reporting provisions of the USRP, the entire system of experience rating may become more skewed toward debit experience modifications and less uniform in application.

For the foregoing reasons, the ALJ finds that the use of employer supplied data is not sufficiently reliable and has the potential to compromise the experience rating system. In addition, the ALJ finds that the requirement of having experience data reported to the WCIRB by insurers in the form of unit statistical reports pursuant to the rules of USRP

reliable statistics and rating information with respect to workers' compensation insurance and employer's liability insurance incidental thereto and written in connection therewith."

⁹⁰ ERP Section III, Rule 3.

balances the necessity of credible and consistently reported data for an equitable statewide experience rating system with the individual employer's need for an experience rating.

C. Grounds Exist To Grant Equitable Relief, Under Certain Circumstances, From The USRP's Time Limitations On Reporting Experience Data To The WCIRB, And From The Retroactive Application Of Experience Modifications For The Period From April 1, 2002, Through December 31, 2003, As Required By The Provisions Of The ERP

An administrative agency's powers are not limited to those expressly granted in the legislation. Rather, "it is well settled in this state that [administrative] officials may exercise such additional powers as are necessary for the due and efficient administration of powers expressly granted by statute, or as may fairly be implied from the statute granting the powers." (*Dickey v. Raisin Peroration Zone No. 1* (1944) 24 Cal.2d 796, 810.) Thus, the Commissioner has invoked equitable principles to relieve an injured party from the strict application of the ERP in the following precedential decisions:⁹¹ *In the Matter of the Appeal of Peeters Transportation Company, Inc. Co.*, File No. ALB-WCA-92-2; *In the Matter of the Appeal of Grayson Service, Inc.* File No. SF-6960-R-83, and *In the Matter of the Appeal of Sierra Children's Home*, File No. SF 6960-R-98.

In each of the above appeals, equity was invoked because of failures of third parties to meet the performance criteria that an insured could reasonably expect of them. In the instant case, Villanova failed to timely and accurately report SRC's 1999 and 2000 experience data pursuant to the provisions of the USRP. As a result, the WCIRB did not have the required experience data to promulgate SRC's 2003 experience modification.

After the ERP was revised on April 1, 2002, the WCIRB was authorized to calculate

⁹¹ Precedential decisions are those administrative law decisions that the Insurance Commissioner designates as being suitable to cite as precedent in subsequent insurance administrative law decisions (Gov. Code Section 11425.60).

SRC's 2003 experience modification without the experience data developed under SRC's 1999 and 2000 Villanova policies. Thus, SRC's 2003 experience modification reflects only the experience developed under its 2001 State Fund policies, all to SRC's detriment.

The WCIRB's argues that SRC should bear the risk of adverse consequences resulting from the insolvency of the insurer it selected. The WCIRB's argument is not persuasive. Insurance Code sections 700 et seq. prescribe the financial requirements an insurer must meet before the Insurance Commissioner will issue it a certificate of authority admitting the insurer to transact business in this state. Ultimately, the Insurance Code mandates that the Insurance Commissioner has the continuing duty to oversee the financial condition of an insurer holding a certificate of authority and is authorized to execute this duty.⁹²

Hence, the court in *Wilson et al. v. All Service Insurance Corp.* (1979) 91 Cal.App.3d 793, 798, held that an insurance broker owed no duty to its clients to investigate the financial condition of an insurer before placing insurance with it on their behalf. In reaching its decision, the *Wilson* court observed that it would be "superfluous, and would create a conflict with the regulatory scheme outlined in the Insurance Code, to impose upon an insurance broker a similar duty to the Commissioner's to ascertain the financial soundness of an insurer. Moreover, the imposition of such a duty would be meaningless in as much as a broker has no power to compel an insurer to divulge information regarding its financial condition." (Id.) Accordingly, the ALJ holds that SRC did not have a duty to investigate the financial condition of Villanova, a company that was authorized to conduct business in California, before SRC purchased an insurance policy from this carrier.

⁹² Insurance Code sections 900 et seq.

Under the circumstances of this case, the ALJ finds that grounds for equitable relief exist. It is common knowledge that SRC and other employers, who have been issued experience modifications late as a result of the failure of their insurers to comply with the ERP and USRP, have been placed in the untenable situation of having to pay increased premiums on policies that have expired. These employers complain that they are not able to recoup the increased costs of their insurance at this late date, and are facing financial hardship as a result of having to pay the increased premiums.

In proposing an equitable remedy, the ALJ recognizes the WCIRB's mandate to administer the experience rating plan under the Insurance Code. Therefore, any form of equitable relief should not unduly hamper the WCIRB's ability to administer the experience rating system or undermine the legislative intent behind the program in its application.

The ALJ recommends the following equitable relief be granted to SRC. Specifically, the rules under USRP Part 4, Section I, Rule 7, ERP Section III, Rule 3(f) and ERP Section V, Rule 7(a), governing the time for reporting and using experience data in the promulgation of an experience modification effective between April 1, 2002, and December 31, 2003, should be waived when either of the following two conditions is met: (1) the WCIRB, in its discretion, determines that the experience data contained in a late reported USR submitted by an insolvent insurer, and needed to calculate an experience modification, is reliable or an ALJ so finds; or (2) the WCIRB has appropriately used the experience data in a late reported corrected USR submitted by an insolvent insurer to calculate a revised experience modification pursuant to Section V, Rule 6 of the ERP.

Likewise, the provision of ERP Section I, Rule 4⁹³ should be waived to prevent the retroactive application of an experience modification above 100% that is effective between April 1, 2002, and December 31, 2003, if the experience modification has been promulgated without experience data from an insolvent insurer.

The corrected USR-1 submitted by Villanova under SRC's 1999 policy meets both of the above criteria. In this case, the ALJ has found that the experience data contained in the corrected 1999 USR-1 Villanova filed with the WCIRB in April 2003 is accurate, and was used by the WCIRB to recalculate SRC's 2002 revised experience modification pursuant to ERP Section V, Rule 6.

If the Insurance Commissioner grants the proposed equitable relief, the WCIRB should rescind SRC's 2003 experience modification of 101%, and recalculate it using SRC's 1999 experience data as reported in the corrected USR-1 submitted by Villanova in April 2003. If the recalculation produces a debit modification, the WCIRB should issue the 2003 debit modification, and it should be applied to SRC's 2003 policy; otherwise, it should not be issued and no modification should be applied to SRC's 2003 policy.

CONCLUSIONS

The ERP authorized the WCIRB to calculate an employer's experience modification without all experience data developed during an experience period when the following conditions are met: (1) the policy is written by a now insolvent insurer, (2) the experience is not reported timely in accordance the USRP, and (3) the liquidator or

⁹³ ERP, Section I, Rule 4 states as follows: "Applicability. An experience modification promulgated in accordance with this Plan shall be applied to the base premium developed in connection with the coverage provided during the effective period of the experience modification."

regulator has advised the WCIRB in writing that experience data will not be submitted by the insolvent insurer.

The ALJ holds that Legion and Villanova are insolvent insurers for purposes of applying the provisions of the ERP pursuant to the May 3, 2002, California Superior Court order appointing the Insurance Commissioner as ancillary receiver of Legion's and Villanova's California assets. Legion and Villanova failed to timely and accurately report SRC's 1999 and 2000 experience data that was needed to calculate SRC's 2003 experience modification. Constructive notice can satisfy the notice requirements of ERP Section III, Rule 3(f), and is given when the appropriate regulator first initiates rehabilitation, conservation, or liquidation of an insurer pursuant to statutory authority and/or judicial order, and USRs that are due are delinquent. The May 3, 2002, order appointing the Insurance Commissioner ancillary receiver of Legion and Villanova's California assets in conjunction with the insurers' failure to timely report experience data constitutes the notice required under the ERP that Legion and Villanova will not be reporting experience data pursuant to the USRP in this case. The WCIRB correctly excluded SRC's 1999 and 2000 policy experience from the calculation of SRC's 2003 experience modification pursuant to the provisions of the ERP.

The ALJ has found that the WCIRB is not able to convert raw experience data into the required USR format needed to promulgate experience modifications. Furthermore, the experience data SRC proffered in lieu of Villanova's USRs is raw experience data that is not reliable under the provisions of the USRP and ERP, and, for both reasons, should not be used to calculate SRC's 2003 experience modification.

The ALJ has found that grounds for equitable relief exist under the circumstances of this case. The rules under USRP Part 4, Section I, Rule 7, ERP Section III, Rule 3(f) and ERP Section V, Rule 7(a), governing the time for reporting and using experience data in the promulgation of an experience modification effective between April 1, 2002, and December 31, 2003, should be waived when either of the following conditions is met: (1) the WCIRB, in its discretion, determines that the experience data contained in a late reported USR by an insolvent insurer that is needed to calculate an experience modification is reliable, or an ALJ so finds; or (2) the WCIRB has appropriately used the experience data in the late reported corrected USR submitted by an insolvent insurer to calculate a revised experience modification pursuant to Section V, Rule 6 of the ERP. The provision of ERP Section I, Rule 4 also should be waived, in order to prevent the retroactive application of an experience modification above 100% that is effective between April 1, 2002 and December 31, 2003, if the experience modification has been promulgated without experience data from insolvent insurers.

The ALJ concludes that the WCIRB should rescind SRC's 101% 2003 experience modification and recalculate it including the experience data developed under SRC's 1999 policy. If the recalculation produces a debit modification, the WCIRB should issue the 2003 debit modification and it should be applied to SRC's 2003 policy; otherwise, the experience rating should not be issued and no modification should be applied to SRC's 2003 policy.

ORDER

1. The WCIRB received constructive notice that Legion and Villanova would not be reporting SRC's experience data according to the provisions of the USRP on May

